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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM 1942

No. 1008

IN THE MATTER

of

PRUDENCE-BONDS CORPORATION,

Debtor.

IN THE MATTER of the Application of CHARLES H. KELBY and CLIFFORD S. KELSEY, as Trustees of the Debtor, and PRUDENCE-BONDS CORPORATION (New Corporation), for an order herein restraining and enjoining all parties to a certain action in the Supreme Court of the State of New York, New York County, entitled "Brooklyn Trust Company, as Trustee under the will of Susanna E. Coffin, deceased, Plaintiff, against President and Directors of the Manhattan Company; George E. Eddy; Hilda S. Reese; and Prudence-Bonds Corporation (New Corporation)," from taking any further steps and proceedings therein.

BROOKLYN TRUST COMPANY, as Trustee of a trust created in and by the will of Susanna E. Coffin, deceased,

Petitioner.

against

CHARLES H. KELBY and CLIFFORD S. KELSEY, as Trustees of the Debtor; PRUDENCE-BONDS CORPORATION (New Corporation); GEORGE E. EDDY; HILDA S. REESE; and PRESIDENT AND DIRECTORS OF THE MANHATTAN COMPANY,

Respondents.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

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BROOKLYN TRUST COMPANY, as Trustee of a trust created in and by the will of Susanna E. Coffin, deceased,

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable the Chief Justice of the Supreme Court of the United States of America and the Honorable the Associate Justices thereof:

Brooklyn Trust Company, as trustee under the will of Susanna E. Coffin, deceased, respectfully prays for a writ of certiorari to review the decision and order of the United States Circuit Court of Appeals for the Second Circuit in the above cause, affirming an order of the United States District Court for the Eastern District of New York entered on August 3, 1942, which order restrains the prosecution or defense of a certain action in the Supreme Court of the State of New York, County of New York, entitled, "Brooklyn Trust Company, as Trustee under the will of Susanna E. Coffin, deceased, Plaintiff, against President and Directors of the Manhattan Company; George E. Eddy; Hilda S. Reese; and Prudence-Bonds Corporation (New Corporation), Defendants."

Opinions Below

The opinion of the District Court (R. 832-854)* is not reported. The opinion of the Circuit Court of Appeals (R. 913-996) is reported in 134 F. 2d, 105.

Jurisdiction

The opinion of the Circuit Court of Appeals was rendered February 16, 1943, and the order for the mandate thereon was entered March 7, 1943. The jurisdiction of this Court is invoked under Section 240a of the Judicial Code, as amended by Act of Congress of February 13, 1925, (U. S. Code, Title 28, Section 347).

Questions Presented

1. Has a District Court in bankruptcy, in a proceeding under Section 77B of the Bankruptcy Act in which the plan of reorganization has been consummated, power to enjoin

* References unless otherwise stated are to folios of transcript.

an action in a state court by a former bondholder of the debtor, which sold its bond prior to the reorganization, against a former indenture trustee of the debtor which has turned over all the debtor's property pledged thereunder to a new trustee pursuant to the plan of reorganization, such action being for damages payable out of the personal property of the defendant?

2. Has such District Court in bankruptcy jurisdiction in a summary proceeding over a person who is not and was not a creditor of the debtor in reorganization and who asserts no claim to any property of the debtor where such person seeks to litigate a claim for damages against a bank which formerly had possession, as indenture trustee, of some of the debtor's pledged property, for breaches of trust in surrendering a part of such pledged property to the debtor while such person was the owner of a bond of the debtor sold by such person prior to the commencement of the reorganization proceeding?

3. If the Bankruptcy Act is construed to sustain the power exercised herein by the District Court in bankruptcy, does it deprive the estate of Susanna E. Coffin, a former bondholder of the debtor, of a right guaranteed by the Fifth Article of the Articles in addition to and amendment of the Constitution?

Statement of Facts

Preliminary Statement

The petitioners for the restraining order were the debtor's 77B trustees, who are not parties to the state court action, and the new corporation formed pursuant to the reorganization proceeding (R. 34). Hilda S. Reese, a bondholder named as defendant in the action, supported the petition but did not join in it. George E. Eddy, another bondholder named as defendant in the action, appeared but neither opposed nor supported the application (R. 27).

Petitioner appeared specially and denied the jurisdiction of the Court to entertain the petition (R. 190-195).

The injunction continues until after the final decree in the proceedings pending in the District Court for the judicial settlement of the accounts of all of the corporate trustees of the debtor's eighteen series of bonds (R. 30-33).[1] The order, affirmed by the Circuit Court of Appeals, also denied this petitioner's motion to dismiss the petition for such restraining order (R. 29).

The reorganization proceedings

The debtor, a New York business corporation, filed its petition for reorganization on June 29, 1934. It had outstanding eighteen series of bonds aggregating about fifty-six million dollars. Each series was secured by a substantially similar trust agreement made by the debtor with a bank as trustee under which securities were pledged and deposited by the debtor with each trustee as security for the payment of the bonds (R. 38).

Separate plans for each of the series of bonds and a general plan providing the mechanics for carrying out the separate plans were confirmed by the District Court January 18, 1938, (R. 44, 47, 255).[2] Under the general plan, the debtor having been adjudicated insolvent, (R. 42 and 254) a new corporation was to be created; its stock was to be placed in a voting trust until March 1, 1943; the voting trust certificates were to be distributed pro rata among the bondholders (R. 45); the debtor and its 77B trustees were to

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[1] That the injunction was a restraint of the parties and was not formally directed against the state court itself (R. 849, 30-33) is immaterial. (*Hill* v. *Martin*, 296 U. S. 393, 403; *Henderson* v. *Fleckinger*, 48 F. Supp. 236, 240.)

[2] The Circuit Court of Appeals in its opinion (R. 922) stated that the order approving the reorganization plans in its entirety was affirmed by that Court. *In re Prudence-Bonds Corporation*, 79 F. 2d 205. While this statement is not important it is erroneous. The decision cited was made on August 8, 1935, several years before this order was made and related to the debtor's right to propose separate plans.

transfer all of their right, title and interest to the new corporation which was to assume and agree to pay the bonds as modified and extended to May 1, 1945. Under each of the separate plans for the several series a separate new trust agreement was to be made and each of the corporate trustees under the original agreements was to transfer the securities held by it to the new corporate trustee (which was formed on February 8, 1938), (R. 50-53).

The District Court by an order made on April 27, 1938, approved the form of the new trust agreement; designated a new trustee; directed the debtor and its trustees to assign all of their right, title and interest in the collateral securing the payment of the bonds to the new corporation; directed each of the former corporate trustees to deliver the collateral constituting the trust funds in its hands to the new trustee and to file an account of its acts and to apply to that Court for the judicial settlement thereof (R. 50-53).

The debtor and its trustees conveyed all of their right, title and interest in all of the trust fund collateral to the new corporation and the bankruptcy court thus surrendered the control it had over the same (R. 53), a new agreement with respect to each of the series of bonds was entered into between the new corporation and the new trustee (R. 53), and the former corporate trustees transferred and delivered all of their respective trust fund collateral in their hands to the new trustee (R. 257-258 and pp. 380-387, former record, *Manufacturers Trust Company* v. *Kelby,* 125 F. 2d 650).

The accounting proceedings

Each of the former corporate trustees thereafter filed an account (R. 54, 68, 69) of its acts and a petition praying that the Court judicially settle the same and discharge it from liability with respect to its acts from the date of each respective agreement.

A question was raised as to the jurisdiction of the bankruptcy court (R. 58) which ruled by order on January 9,

1939, that it had no jurisdiction over the accounts and objections that might be made thereto in so far as they related to acts of the accounting trustees prior to the date of commencement of the reorganization proceeding in permitting the debtor to withdraw some of the trust fund collateral in alleged violation of the trust agreements (pp. 421, 422 former record). Upon appeal the order of the District Court was reversed by the Circuit Court of Appeals. (*Central Hanover Bank & Trust Company, et al.* v. *Manhattan Company et al.*, 105 F. 2d 130.)

While the Circuit Court of Appeals decided that the District Court was not without jurisdiction over the claims of then bondholders which related to the acts of the accounting trustees prior to June 29, 1934, in permitting the debtor to substitute or withdraw collateral, it decided that the District Court *might* if it saw fit include such claims in the accountings; that it did not follow that it will prove more convenient to do so and the District Judge was free to choose that forum which he thought would best serve the interests of all parties.

The District Court thereupon made an order on July 12, 1939, in which it stated that "to make effective, consummate and carry out" the confirmed plans, it had and thereby took "full, complete and exclusive jurisdiction" over the accounts and objections thereto, including objections to acts of the corporate trustees in permitting the alleged substitutions and withdrawals of collateral by the debtor (R. 60-64).

On October 2, 1939, the new corporation and the debtor's trustees filed objections to the accounts of all but one of the corporate trustees (R. 70-77). Objections to the accounts of some of these trustees were filed by individual bondholders on behalf of all bondholders (R. 70-77). The accounts and objections were referred to a Special Master (R. 78). The objections to such accounts relate mainly to the trustee's acts in permitting the debtor to (1) withdraw bonds and mortgages upon the substitution of other bonds and mort-

gages and/or cash and (2) excess cash from the respective trust funds in alleged violation of the agreements (R. 71).[3]

Manufacturers Trust Company, former trustee of the twelfth series, and Brooklyn Trust Company, former trustee of the eighth series, while hearings on objections to certain other accounts were pending before the Special Master, moved before him for summary judgment dismissing all of the objections to their accounts other than those of certain individual bondholders on the ground that the objectors were not real parties in interest and had no standing to maintain objections; and on the further ground that they were barred by the statute of limitations (R. 81). The Special Master by report in each case dated April 17, 1941, recommended that the motions be granted in so far as they sought dismissal of the objections of the new corporation, the debtor's trustees and Prudence Securities Advisory Group, an intervening objector; that no bondholder had the right to object to the accounts on behalf of bondholders as a class and that bondholders who acquired their bonds after the acts objected to had no right to object. The Special Master recommended the denial of the motions in so far as they sought dismissal of the objections on the ground they were barred by the statute of limitations (R. 81).

The District Court on July 10, 1941, reversed the Special Master in part and denied the motions in all respects (p. 500, former record). Both banks appealed from the respective orders denying their motions. The appeal of Brooklyn Trust Company was held in abeyance pending the outcome of the appeal of Manufacturers Trust Company.

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[3] There is no claim that the accounts as rendered are false or inaccurate or incomplete. They are *qua* accounts; therefore not contested. They are merely informative the same as a bill of particulars; a statement of undisputed transactions, and they now serve only as a fact basis by which bondholders seek damages. Nor is there any process of identification of trust *res* in the hands of the former trustees, which is usually a process of accounting, involved here.

The Circuit Court of Appeals on said appeal (*Manufacturers Trust Company* v. *Kelby,* 125 F. 2d 650) ruled (1) that a former bondholder or assignor of a bond of the debtor who transferred his bond prior to the debtor's reorganization had no standing to complain of the substitutions and withdrawals of a part of the collateral of the debtor permitted by the corporate trustees while he was a bondholder and before the assignment of such bond; (2) that, being a question as to the effect of an assignment of a bond made in New York, the decisions in that state are authoritative; (3) that the causes of action based on such acts on the part of the corporate trustees were in their nature derivative and that the bondholders at the time of any recovery were entitled to the benefits thereof; and (4) neither the debtor's trustees nor the new corporation were indispensable parties to the accounting proceeding. Petition for certiorari was denied, 316 U. S. 697. The appeal of Brooklyn Trust Company was thereafter withdrawn.

The complaint in the state action

The state action, in which petitioner here sues as trustee of a testamentary trust and not in any individual capacity or as trustee of any bonds formerly issued by the debtor, was instituted on June 24, 1942. Plaintiff therein sued in the fulfilment of its duty as a testamentary trustee to enforce rights which it possesses as such for the benefit of beneficiaries and remaindermen of the testamentary trust who are the real plaintiffs in the action (R. 248).

The complaint alleges that Susanna E. Coffin bought a one-thousand-dollar Prudence bond, fifth series, on January 18, 1926, and held it at her death on November 4, 1931 (R. 245-248). On March 28, 1932, more than two years prior to the filing of the debtor's petition for reorganization, this petitioner as executor of Mrs. Coffin's will, sold the bond for five hundred eighteen dollars and seventy-five cents (R. 250) and later turned the residuary estate, including the proceeds of the bond, over to itself as testa-

mentary trustee, accounting and being discharged as executor, and it is now acting as trustee for the beneficiaries and remaindermen of said trust (R. 251); that between January 18, 1926, when testatrix bought the bond, and March 28, 1932, when it was sold, Manhattan Company, as trustee of the series, allowed the debtor to withdraw cash and bonds and mortgages not in default while other mortgages were in default, in violation of the trust agreement and to the damage and injury of testatrix, her estate and plaintiff (R. 248-250).

The indenture under which Manhattan Company became trustee, the issuance of the bonds and the subsequent reorganization of the debtor are alleged (R. 243-245, 252-259).

It is then alleged that pursuant to order of the District Court, defendant Manhattan Company filed an account of its acts as trustee (R. 259) and that objections were filed by defendants Eddy and Reese on behalf of themselves and all other then bondholders (R. 260).

The nature of these objections is then set forth (R. 260-263) showing they assert that no sum recovered from Manhattan Company for its acts committed between January 18, 1926 and March 28, 1932 will be payable to the Coffin Estate or others who owned bonds at the time of such acts and later sold their bonds but that any amount so recovered will be added to the collateral securing the *modified* fifth series bonds for the benefit of the bondholders of this series at the time of such recovery and, if their bonds are paid in full, for the benefit of other parties *who are not bondholders of this series.*

It is then alleged and cannot be denied that petitioner and other former bondholders of the debtor who sold their bonds prior to the institution of the debtor's reorganization proceeding were parties neither to this reorganization proceeding nor to the proceeding to settle the accounts of the corporate trustees, since they were neither creditors of nor claimants against the debtor or its property when either proceeding was instituted (R. 263-264) and were never classified as such (R. 298-327).

The decision of the Circuit Court of Appeals in *Manufacturers Trust Company* v. *Kelby, supra,* is set forth and it is alleged that it does not conform to the law of New York and is not an authority binding upon its courts (R. 265-267).

The prayer for relief is for a money judgment against Manhattan Company in its individual capacity (R. 267).

This action therefore does not attempt to reach any property or *res* which ever constituted a part of the debtor's estate or over which the bankruptcy court had, has or can obtain jurisdiction.

The action is pending only against Manhattan Company and Prudence-Bonds Corporation (New Corporation) (R. 99, 198-201, 213-214, 232). Eddy and Reese, while named parties defendant, have not been served with process and have not appeared in the action; consequently, no action is pending as to them. No judgment recovered will be *res adjudicata* as to them unless they are served with process or appear therein.

Facts alleged in the petition for injunction

The petition on which the restraining order was granted sets forth at length the steps, beginning on June 29, 1934 in the proceedings for the reorganization of the debtor to and including the denial by this Court on June 21, 1942 of certiorari to review the decision of the Circuit Court of Appeals in *Manufacturers Trust Company* v. *Kelby,* which facts have been summarized.

The petition also alleges settlement of objections to the accounts of three trustees of certain of the debtor's series of bonds, the relevancy of which is not apparent upon the issue presented and the same applies to what follows in the petition.

The petition further alleges circumstances surrounding the commencement of the action in the state court and that petitioner is testamentary trustee and trustee of another trust in which it holds other bonds of the debtor and has not commenced any action or proceeding or asserted any

claim or assignment with respect thereto or filed in the debtor's proceeding any proof of claim asserting any right to any portion of any recoveries for the acts complained of in the objections to the account of Manhattan Company (R. 96-110);

That the action commenced in the state court constitutes an unlawful interference with the processes and proceedings of the District Court in connection with the administration of the debtor's estate under the Bankruptcy Act and an unlawful interference with the proceedings for the settlement of the accounts of the corporate trustees of the various series of bonds of the debtor over which the District Court has jurisdiction (R. 110);

That it appears from the *amended* complaint in the action (since superseded by a second amended complaint) (R. 241-267), that the principal object and effect of the action is and would be to review, circumvent and render ineffectual the order of the District Court dated August 29, 1941, in the *Brooklyn Trust Company* case (Eighth Series) and the order and decree made on September 3, 1941, in the *Manufacturers Trust Company* case (Twelfth Series) as affirmed by the Circuit Court of Appeals, and the order and decree made on July 12, 1939, on the mandate of the Circuit Court of Appeals filed July 1, 1939, in *Central Hanover Bank and Trust Company* v. *Manhattan Company, supra*, and that unless the parties are restrained from taking any further proceedings until after the final decree the further result will be that petitioner and other parties and bondholders interested in the debtor's estate and the accounting proceedings herein will needlessly be required to perform substantial services and incur substantial expenses, all or part of which will be chargeable to the trust funds, and impede and delay the closing of the debtor's estate (R. 110-119). It is lastly alleged that the action in the state court has not been instituted in good faith (R. 119-128), which is not germane and which is solely a matter for decision by the state court.

Specifications of errors to be urged

The Circuit Court of Appeals erred in the following respects:

(1) In holding, in conflict with both New York law and the decisions of this Court, that the institution and maintenance of the action by this petitioner in the state court interferes with any jurisdiction of the bankruptcy court.

(2) In holding, in conflict with both New York law and the decisions of this Court, that any recovery by petitioner in the action in the state court from Manhattan Company will interfere with any jurisdiction of the bankruptcy court.

(3) In holding, in conflict with the decisions of this Court and other Circuit Courts of Appeals and its own former decisions, that the District Court had power, authority and jurisdiction to restrain petitioner by a summary proceeding from prosecuting its action in the state court.

(4) In confirming and relying upon its decision in *Manufacturers Trust Company* v. *Kelby* and in holding, in conflict with New York law, that a corporate bondholder's cause of action against a trustee under an indenture securing the payment of bonds for breaches of trust, which consist of the surrender or release of portions of the pledged or mortgaged property to the debtor-obligor while he was such a bondholder, passes *ipso facto* with a transfer of the bond and is inseparable from it.

(5) In holding, in conflict with New York law, that a derivative suit may be maintained on behalf of the bondholders' security against a trustee under an indenture securing the payment of the bonds for breaches of trust in connection with the pledged or mortgaged property which do not involve the acquisition of title to or an appropriation of such property by the trustee individually and its possession thereof or of its substitute.

(6) In holding, in conflict with New York law, that a derivative suit may be maintained on behalf of the bondholders' security against a trustee under an indenture securing the payment of the bonds for breaches of trust in surrendering or releasing portions of the mortgaged or pledged property to a debtor-obligor.

(7) In holding, in conflict with New York law, that a suit may be maintained by a bondholder against a trustee under an indenture securing the payment of bonds for breaches of trust in connection with the surrender or release of a portion of pledged or mortgaged property to a debtor-obligor, which acts occurred prior to the time he became a bondholder.

(8) In holding, contrary to its two former rulings, that the proceeding in the District Court for the judicial settlement of the account of Manhattan Company is a proceeding in or a part of the debtor's reorganization proceeding subject to the jurisdiction of the bankruptcy court.

(9) The decision of the Circuit Court of Appeals deprives petitioner and other former corporate bondholders similarly situated, that is, who were such when a trustee under an indenture securing the payment of such bonds surrenders some of the pledged property which secured the bonds to the debtor-obligor, of their property without due process of law.

Reasons for granting the writ

The Circuit Court of Appeals, as will be shown in the brief herewith, has:

1. Decided a Federal question in conflict with applicable decisions of this Court and of other Circuit Courts of Appeals and of its own former decisions.

2. Construed a Federal statute so as to render it unconstitutional.

3. Decided an important question of New York property law in conflict with applicable New York decisions and with those of this Court.

4. The propositions of law involved are of public important since they affect the property rights of a great number of former holders of corporate bonds not only of the debtor but of other corporations. Since the decision of the Circuit Court of Appeals is inconsistent with the law of New York, the rights of bondholders and the nature of the liability of trustees under indentures securing the payment of bonds depends now and until the questions herein presented depend upon whether a suit is brought by a bondholder in a New York State Court or in a Federal Court.

Conclusion

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari should be granted to review said decisions and order of the Circuit Court of Appeals for the Second Circuit.

Dated, Brooklyn, New York,
May 6, 1943.

BROOKLYN TRUST COMPANY,
as Trustee under the will of
Susanna E. Coffin, deceased,
Petitioner,

By: JACKSON A. DYKMAN and
RALPH W. CROLLY,
Counsel for Petitioner.